



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Edward K. Shikada

**SUBJECT: MEDICAL MARIJUANA -  
FEES, CHARGES &  
MARIJUANA BUSINESS TAX**

**DATE:** July 24, 2014

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## **RECOMMENDATION**

- (a) Adopt a resolution amending the 2014-2015 Schedule of Fees and Charges (Resolution No. 72737, as amended) to:
  - (1) Establish a fee for the Receipt of an Application for Registration as a Medical Marijuana Collective in the amount of \$152 per application;
  - (2) Establish a fee for the Processing of a Zoning Code Verification Certificate Application in the amount of \$900 per application plus applicable hourly fees after 4 hours;
  - (3) Establish a fee for the Processing of an Application for Registration as a Medical Marijuana Collective in the amount of \$2,256 per application plus \$125 per hour for additional Code Enforcement inspection services beyond the first hour and a Police Department Sworn Hourly Investigation fee in the amount of \$93 per hour beyond 15 hours and \$181 per employee above four;
  - (4) Establish Hourly Inspection Fees for additional inspection services potentially needed to be completed by the Planning, Building & Code Enforcement Department (PBCE) in the amount of \$154 per hour for Planning and in the amount of \$125 per hour for Code Enforcement; and
  - (5) Establish a Police Department Sworn Hourly Investigation Fee in the amount of \$93 per hour.
- (b) Council discussion and consideration of a proposed Marijuana Business Tax measure for the November 4, 2014 Election that would increase the current 10% maximum rate of the tax to a maximum rate of up to 20% of gross receipts;
- (c) Adopt a resolution of the City Council calling and giving notice of, on its own motion, a Special Municipal Election to be held on November 4, 2014, to submit to the electors of the City of San José the following measure:

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**MEASURE - Marijuana Business Tax Rate Increase**

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| To provide funding for services such as police, fire, 9-1-1, street maintenance, pothole repair, parks, libraries and youth/senior programs, shall the Marijuana Business Tax be amended to increase the 10% maximum rate to a maximum rate of up to 20% of gross receipts on marijuana businesses in San José, subject to existing independent financial audits, with all revenue controlled locally and no rate increase for any other businesses? | YES |  |
|  | NO  |  |

- (d) Council discussion and consideration of adopting of provisions to permit rebuttal arguments in the November 2014 Voter's Sample Ballot, pursuant to Elections Code Section 9285.

**OUTCOME**

Should the City Council approve the items outlined in this memorandum, the following changes to the Medical Marijuana Program would result: (1) The re-establishment of the Medical Marijuana Regulatory Fees for the application process to provide for full cost recovery of the expenditures incurred by the City during the registration of Collectives to confirm Collectives are operating within the parameters of the City's Medical Marijuana Regulatory Program ("Program"); and, (2) approval by the City Council of the proposed Marijuana Business Tax amendment ballot measure for voter consideration of an increase in the Marijuana Business Tax, at the November 4, 2014 General Municipal Election, from a maximum of 10% to a maximum of 20%.

**EXECUTIVE SUMMARY**

On June 17, 2014, the City Council approved a Program that regulates where medical marijuana establishments can operate in the City and how they can operate. That Program requires all medical marijuana establishments operating in San José including, but not limited to: collectives, cooperatives, and dispensaries (hereafter, "Collective(s)") to register with the City. To remain consistent with the City Council's direction that the Program achieve full cost recovery, the Administration is recommending the adoption of certain fees and charges to cover City expenses to implement the Program.<sup>1</sup>

At the June 17, 2014 City Council meeting, the City Council also addressed the need for new revenue sources to facilitate the restoration of City services to acceptable levels. Council directed staff to conduct public polling on marijuana taxation for City Council discussion on

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<sup>1</sup> The Administration is also in the process of developing a correlating staffing plan and fee structure necessary to effectively regulate the Program after the initial registration period ends and intends to bring additional fee recommendations to the City Council in January 2015.

August 5, 2014, and to present the Council with ballot language to increase the 10% maximum rate of the Marijuana Business Tax for the November 4, 2014 election.

## **BACKGROUND**

### **Collective Registration Fees:**

On June 17, 2014, the City Council approved a Program that regulates where Collectives can operate in the City and how they can operate. That Program requires all Collectives to register with the City. Beginning July 18, 2014, Collectives have ninety (90) days to apply for registration and one (1) year to become registered. Registration with the City requires each Collective to complete and submit the following forms: (1) a Zoning Code Verification Certificate Application, establishing that the Collective is operating in an area that complies with the Program's land use regulations, and (2) an Application for Registration as a Medical Marijuana Collective, evidencing that the Collective will operate in strict compliance with the Program's operational regulations.

On July 11, 2014, the Administration issued an Information Memorandum that outlined upcoming events to assist Collectives in the registration of their establishments. The memorandum referenced a Registration Q & A session that the Administration hosted in the Council Chambers on July 16th to prepare Collectives for the registration process. Approximately 70 Collectives attended the Q & A and asked a host of questions specific to the City's registration process.

On July 18, 2014, the City began its first day of receiving applications from Collectives. For the convenience of Collectives, the City held an event that was staffed by representatives from the City Manager's Office, PBCE, the Police Department, and the Department of Public Works. In addition, members from the City's security team, as well as private security officers, were on hand to ensure the event ran smoothly. In total, 18 Collectives came to discuss the registration process with City staff and 14 Collectives submitted applications for Zoning Code Verification Certificates. No applications for Registration as a Medical Marijuana Collective were submitted as Collectives indicated they wanted to use the 90 days allotted to ensure this particular application was correctly completed before it was submitted. Staff received the applications for Zoning Code Verification Certificate, provided a receipt to the applicants showing proof that the application had been received by the City, and provided informational materials to further assist applicants through the registration process. Staff then advised applicants that they would be invoiced for the City's receipt and processing of their applications for a Zoning Code Verification Certificate.

### **Marijuana Business Tax (MBT):**

On November 2, 2010, the citizens of San José voted to approve Measure U which allows the City of San José to tax all marijuana establishments. As a result, the Marijuana Business Tax was established (San José Municipal Code Chapter 4.66 hereafter referred to as "Code"). Per Section 4.66.250 of the Code, the City Council, by ordinance, can set a tax rate not to exceed 10% of gross receipts. The tax became effective March 1, 2011 with Council setting the initial rate at 7% of gross receipts when the City Council adopted Ordinance No. 28867. The rate was increased to 10% of gross receipts effective July 1, 2013 when the City Council adopted Ordinance No. 29262.

### **Recent Polling for Increase in rate of MBT:**

As directed at the June 17, 2014 City Council meeting, the Administration conducted polling between June 30 and July 3, 2014 and July 7 and July 10, 2014, analyzing an increase in the Marijuana Business Tax rate. As discussed in a separate memorandum, a telephone survey of 1,515 randomly-selected City of San José likely November 2014 voters was conducted. The results of the survey showed a strong support for the City's recently adopted Medical Marijuana Regulatory Program and a solid majority of likely November 2014 voters would support increasing the Marijuana Business Tax from 10% to 20% of gross receipts.

### **ANALYSIS**

Included in this memorandum are various recommendations to amend the Medical Marijuana Regulatory Program, including amendments to both the application fees noted in the City's Schedule of Fees and Charges, as well as the Marijuana Business Tax.

### **Medical Marijuana Regulatory Application Fees & Charges**

Below details the recommended fees related to the acceptance and processing of applications for a Zoning Code Verification Certificate and Registration as a Medical Marijuana Collective:

- (1) A Fee for Receipt of a Application for Registration as a Medical Marijuana Collective;
- (2) A Processing Fee to process an application for a Zoning Code Verification Certificate (Title 20);
- (3) A Processing Fee to process an Application for Registration as a Medical Marijuana Collective (Title 6);
- (4) An Hourly Inspection Fee to cover additional inspections by PBCE to verify Zoning Code compliance; and
- (5) An Hourly Investigation Fee to cover additional investigation by the Police Department to verify compliance with the Program regulations.

*A Fee for Receipt of an Application for Registration as a Medical Marijuana Collective*

A fee in the amount of \$152.00 is recommended to cover staff costs associated with receiving each Application for Registration as a Medical Marijuana Collective. This fee assumes that staff will require one (1) hour per application to fulfill the needed administrative/processing tasks. The administrative tasks associated with the Application Receipt Fee and administrative process is generally:

- Time to make contact with each applicant to ensure the correct contact information has been placed on each application and answer questions applicants have regarding the application and the process;
- Issuance of a receipt to the applicant for each application submitted; and
- Staff time to log each application to ensure that each application is processed in the order in which it was received.

*A Processing Fee to process a Zoning Code Verification Certificate (Title 20)*

The Zoning Code Verification Certificate will be the mechanism to confirm that a Collective meets the land use requirements of the City's Zoning Code. To cover the costs associated with these activities, the Administration proposes a new fee be added to the Schedule of Fees and Charges to process applications for a Zoning Code Verification Certificate. Given the need to accept the application, do preliminary research of GIS data, review imaged plans of approved development permits, do field verification, measure distances of the subject site from various sensitive land uses, and conduct an inspection to ensure Code compliance through in-person site visits, PBCE estimates that a basic processing time to issue approval or denial of an application for a Zoning Code Verification Certificate is six (6) hours. This amount of time would result in a base fee of \$900 per application, plus additional hourly fees after six (6) hours to process the application. It should be noted that the fee includes the General Plan Update surcharge as defined in City's Schedule of Fees and Charges.

*A Processing Fee to process an Application for Registration as a Medical Marijuana Collective (Title 6)*

The Processing of an Application for Registration as a Medical Marijuana Collective will be the mechanism to confirm that a Collective follows and intends to comply with Chapter 6.88 of the Code. This process will require several City departments to review multiple documents showing the Collective's intent to abide by all Program regulations. For example, City staff will be required to review, investigate, and process the items identified below:

1. Management Plan;
2. Security Plan;
3. Collective's Cultivation Procedures;
4. Site Floor Plan;
5. Collective's Rules and Regulations;

6. Collective's Odor Management Plan; and
7. Criminal Background Checks.

To cover the costs associated with these activities, the Administration proposes a fee of \$2,256 per application, which includes 16.5 hours to review documents and background up to a total of four (4) owners, managers and specified employees, be added to the Schedule of Fees and Charges to process this application. The fee assumes that the following classifications will assist in the 16.5 hours of review: Sergeant, Police Officer, Analyst, Senior Executive Analyst, Code Enforcement Inspector, and Assistant to the City Manager. The Administration further proposes an applicable fee of \$181 for each individual requiring backgrounding, beyond the initial four (4) covered by the base fee, be added to the Schedule of Fees and Charges. This additional fee will cover each Collective owner, manager and any individual participating in the cultivation, processing, manufacturing, transporting or dispensing of medical marijuana.

#### *Hourly Inspection Fee*

In addition to the base fees to process either application, there may be locations which require more inspection time to confirm compliance with the Program requirements. In order to ensure full cost recovery of the additional time and resources needed in those instances, additional hourly rates may be assessed as outlined in the PBCE 2014-2015 Adopted Schedule of Fees and Charges, and as necessary, for example:

- Planning Division – Additional time for research and site checks may be necessary for some applications. This additional processing time would require billing at the standard Planning Division hourly rate of \$154, plus a General Plan Update surcharge as defined in the City's Schedule of Fees and Charges.
- Code Enforcement – Additional time for inspections that may be necessary for some applications. This additional work would require billing at the standard Code Enforcement Division hourly rate of \$125, plus a General Plan Update surcharge as defined in the City's Schedule of Fees and Charges.

#### *Hourly Investigation Fee*

In some situations, it is expected that the Police Department will be required to spend additional time on certain applications for Registration as a Medical Marijuana Collective. In order to ensure full cost recovery of the additional time and resources needed in those instances, additional hourly rates may be assessed as outlined below, for example:

- Police Department – The Administration recommends the City Council adopt a Police Sworn Hourly Investigation Fee in the amount of \$93 per hour for additional review and verification of the various plans associated with the application for Registration as a Medical Marijuana Collective and for additional time needed to inspect the Collective's locations and premises, which may include a separate cultivation site in Santa Clara County or in one of the contiguous counties. Because staffing is not currently available

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for this work, the recommended fee assumes cost recovery for the Sergeant currently assigned to the City's Medical Marijuana Team to conduct these reviews and investigations on an overtime basis. As a result, this fee does not include fringe/retirement costs or the overhead rate typically captured when a sworn FTE performs this function as part of his or her normal duties. As the City moves toward full implementation of the Program, the Administration will reexamine this hourly rate to determine whether moving away from the use of overtime is a viable and more efficient option.

### **Marijuana Business Tax - Potential Ballot Measure**

In order to evaluate the potential level of public support for a November ballot measure regarding the amendment to the Marijuana Business Tax, between June 30 and July 3, 2014 and July 7 and July 10, 2014, a telephone survey of 1,515 randomly-selected City of San José likely November 2014 voters was conducted. The results of the survey showed a strong support for the City's recently adopted Medical Marijuana Regulatory Program and a solid majority of likely November 2014 voters would support increasing the Marijuana Business Tax from 10% to 20%. If a Marijuana Business Tax increase is placed on the ballot and approved by the voters in November, the anticipated implementation date for the increase is March 1, 2015.

At the current rate of 10%, the Marijuana Business Tax is anticipated to generate approximately \$6 million annually that is budgeted in the General Fund. Therefore, should there be no change in activity levels, revenues could reach up to \$12 million with the implementation of a 20% gross receipts tax, resulting in an additional \$6 million annually. In 2014-2015, the tax rate would be in effect for four months, generating up to an additional \$2 million. However, it is important to note that there is a significant amount of uncertainty surrounding this estimate primarily due to two major factors that may impact activity levels: the change in the program and the impact on demand due to a rate increase. The Marijuana Business tax revenues are dependent on the number of Collectives that remain in business following full implementation of the Medical Marijuana Regulatory Program. Enforcement of the Program may also impact demand for the product. Furthermore, increasing the tax rate may increase the cost of the product and thereby cause a decrease in product demand. Therefore, it is difficult to project the amount of revenue that would be generated by increasing the tax by up to 20% of gross receipts. It is currently estimated that activity levels may fall 10% to 20%. For instance, if activity levels drop 10%, the ongoing revenues generated by the Marijuana Business Tax would range from \$5.4 million based on the current tax rate of 10% to \$10.8 million based on a tax rate of 20%.

For reference, the cardrooms operating in the City are currently assessed at 15% tax rate on gross receipts. Should a 15% tax rate be implemented for the Medical Marijuana Program, revenues may range between \$7.2 million and \$9.0 million. This range depends on whether the current receipt levels are maintained and whether enforcement of the Program impacts demand for the product.

### *Ballot Measure Rebuttal Arguments*

If the City Council wishes to allow rebuttal arguments to the Marijuana Business Tax amendment ballot measure, then the resolution calling for the Special Municipal Election will provide for rebuttal arguments pursuant to Elections Code Section 9285. If allowed by the City Council, the City Clerk may accept rebuttal arguments from either the author(s) of a primary argument in support of or opposition to a ballot measure, or any other person(s) authorized in writing by the author(s) to submit a rebuttal argument. Rebuttal arguments may not exceed 250 words and may be signed by no more than five (5) persons.

### **EVALUATION AND FOLLOW-UP**

The fees discussed in this memorandum will ensure that the City recovers all costs associated with Collectives applying to and registering with the City of San José. However, due to a number of unknown variables (e.g. number of successfully registered Collectives, potential regulatory actions, monitoring time requirements, etc.) none of the proposed fees consider or support the City's ongoing expenses to regulate Collectives. To address this issue, the Administration intends to return to the City Council in January of 2015 to establish the final Program staffing plan, as well as the fees associated with operating the Program on an annual basis.

If Council adopts a resolution to submit a measure increasing the Marijuana Business Tax to the voters on the November 2014 ballot, arguments for and against the measure, would be due to the Registrar of Voters by 12:00 noon on August 8, 2014. The City Attorney's impartial analysis would be due to the City Clerk by 12:00 noon on August 19, 2014.

### **POLICY ALTERNATIVES**

*Alternative #:* ***The City Council could elect not to approve the fees as discussed in this memorandum.***

**Pros:** None.

**Cons:** Yes, please see below.

**Reason for not recommending:** The City would be unable to cover the costs to receive and process Medical Marijuana application and registration documents which would contradict Council's direction of establishing a full cost recovery program.

### **PUBLIC OUTREACH/INTEREST**

- ☐ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- ☒ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**



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- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

If the City Council does approve ballot measure language for a Marijuana Business Tax amendment ballot measure, then staff will be guided by the City Council approved *Community Engagement Process* to develop the best approach to ensure that the public receives accurate information from now until the election in November. In addition, staff will make certain that all the appropriate information is posted to the City's website.

The role of City staff, with respect to any ballot measures, is to provide accurate and impartial information to the public. City staff are prohibited from using City resources to participate in campaigns in support or in opposition of any ballot measure. The role of the City Attorney's Office is to assist staff in developing the ballot measure and, if the measure is submitted to the voters, the impartial analysis of the measure that is included in the voter handbook.

### **FISCAL/POLICY ALIGNMENT**

A Marijuana Business Tax is in alignment with the City Council's direction at the June 17, 2014 City Council meeting to develop proposed ballot measure language for the November 2014 General Municipal Election that "includes the amendment to the Marijuana Business Tax."

### **COST SUMMARY/IMPLICATIONS**

The Fees and Charges recommended in this memorandum have been set at a level that will recover the costs associated with the registration application process. At this time, the activity levels associated with the process are unknown, therefore no budget actions are recommended in this memorandum. However, once more information about the number of applicants is available, the Administration will return to the City Council to recognize the revenues and expenditures associated with these fees. It is estimated that revenues may reach \$150,000 to \$350,000 depending on activity levels. It is further anticipated that additional resources will be necessary to support this Program, including a temporary Analyst position in the Police Department. In addition, as approved by the City Council, in the Mayor's June Budget Message for Fiscal Year 2014-2015, temporary resources were added to the City Attorney's Office (1.0 Deputy City Attorney), the Planning, Building & Code Enforcement Department (1.0 Code Inspector), and the Police Department (\$100,000 in overtime) to assist during this transition period.

As discussed in the Evaluation and Follow-up Section, in addition to returning to recognize revenues and expenditures associated with the application process, the Administration plans to return to the City Council in January of 2015 to establish the final Program staffing plan as well as the fees associated with operating the Program on an annual basis.

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The City Clerk will issue a separate memorandum which provides the ballot measure costs and the associated budget related to the placement of a tax measure on the ballot, as well as the authorization for rebuttal arguments and the publication of the full text of the measure.

The impact of the implementation of the Medical Marijuana Regulatory Program on the Marijuana Business Tax receipts will be monitored closely and any necessary adjustments will be brought forward in 2014-2015 and reported through the Bi-Monthly Financial Reports. If a ballot measure moves forward and is approved by the voters, budget adjustments will be brought forward in 2014-2015 and incorporated into the 2015-2016 Proposed Budget.

### **COORDINATION**

This memorandum was coordinated with the City Attorney's Office, the Police Department, the Finance Department, and the Department of Planning, Building and Code Enforcement.

### **CEQA**

Statutorily Exempt, CEQA Guidelines Section 15273, Rates, Tolls, Fares and Charges (File No. PP10-067 (a)).

  
EDWARD K. SHIKADA  
CITY MANAGER

For questions please contact Angelique Gaeta, Assistant to the City Manager, at (408) 535-8253.

